Regulation of actionable ISP projects: summary of stakeholder forum on the AER's draft guidance note

10 March 2021

We have published this summary of the issues raised at our stakeholder forum on 28 January 2021 alongside the written submissions we received to inform the development of our guidance note. Where we can, we have expanded on some of the responses we provided at the forum to assist stakeholders. Some issues raised at the forum are beyond the scope of the guidance note but we have sought to provide a response where possible.

We would like to thank stakeholders for their input, both through our forum and through written submissions. We are considering all the input we received and working to finalise the guidance note by end March-early April 2021.

Table 1: Summary of stakeholder forum discussion

Stakeholder question	AER response
Application of guidance note Would the guidance note apply to Project EnergyConnect? Could it be used as a case study to inform the guidance note? Would the guidance note apply to actionable Integrated System Plan (ISP) projects that are procured by the Australian Energy Market Operator (AEMO) through bid-based competitive tendering, under the Victorian planning arrangements?	We expect that transmission network service providers (TNSPs) will have regard to the guidance note when proposing forecast expenditure associated with actionable ISP projects, particularly after the guidance note has been finalised and published (see section 1.1 of the draft guidance note). The relevant TNSPs submitted contingent project applications (CPAs) for Project EnergyConnect in September 2020.[1] As the guidance note is still under development, those TNSPs have not had the opportunity to prepare their CPAs in accordance with the expectations set out in the guidance note. Our guidance note has been informed by our recent experiences assessing the Project EnergyConnect CPAs. We also propose to update the guidance note periodically as we, and TNSPs, continue to learn from the experiences of assessing and delivering actionable ISP projects, and will consult with stakeholders accordingly. Our guidance note provides information about how we intend to assess expenditure for actionable ISP projects under the economic regulatory framework set out in chapter 6A of the National Electricity Rules (NER). As such, it only applies to projects regulated under this framework. It would not apply to actionable

[1] On 24 November 2020, ElectraNet submitted an update to its contingent project application. Further detail on this can be found on the AER website here.

	ISP projects that are competitively procured by AEMO.
CPA process: Interaction with CESS How will the proposed risk allowance interact with the application of the capital expenditure sharing scheme (CESS), which is designed to mitigate TNSPs' exposure to cost overruns?	The CESS applies to how a TNSP's actual capital expenditure (capex) compares to the total forecast capex (or allowance) we approve through the revenue determination process. Incorporating quantified risk allowances into the forecast does not change the way the CESS incentivises TNSPs to outperform their capex allowance, and shares efficiency gains/penalties with consumers.
CPA process: Pre-lodgement engagement Are the pre-lodgement engagement expectations in the draft guidance note contained to issues and information that has not already been the subject of the RIT-T and ISP processes (including the AEMO feedback loop)?	The principles in pre-lodgement engagement are intended to apply to the development of expenditure forecasts contained in a TNSP's CPA. We would not necessarily expect TNSPs to re-engage on issues and information that have already been consulted on at the earlier ISP or regulatory investment test for transmission (RIT-T) stages for the project. However, re-engagement on certain issues that impact the cost forecasts may be appropriate as a result of developments in the project, such as material changes in scope or costs. We will consider whether to include further guidance or clarification on this in the final version of the guidance note.
CPA staging: capex endorsement Where a commitment by the TNSP's Board to proceed is required before an AER CPA decision, is there an opportunity to stage the AER's CPA decision by first endorsing a capex allowance before making a revenue determination?	Board commitment is not a requirement for an AER contingent project determination under the new ISP framework. The ISP framework specifies 'trigger events' for actionable ISP projects in the NER, which do not include Board commitment. There is no mechanism under the NER that allows the AER to 'endorse' a capex forecast. Under the current framework, the AER determines the expenditures and incremental revenue required to deliver a contingent project, having assessed a TNSP's CPA. Recently, we did provide a preliminary view on the prudent and efficient capital cost for Project EnergyConnect in order to continue to progress the project noting that we were not yet satisfied that the project trigger event has occurred.[2] Section 2.3 of the draft guidance note sets out that we think it is helpful for the TNSP to advise whether its Board has committed to proceeding with the project and whether financing for the project has been obtained. We are open to considering how we can, within the rules and as appropriate, work with TNSPs and exchange information to assist them in preparing their contingent project application.
CPA staging: early works If TNSPs are reluctant to do early works, could they apply to get funding for that as	TNSPs could seek to have forecast expenditure for early works incorporated into their revenue allowance through the revenue determination process, or they could seek an allowance for this work through the

2 See AER, TransGrid and ElectraNet – Project EnergyConnect contingent project overview page.

part of their normal revenue reset process, and consumers pay for it?	CPA process. This could occur through a fully 'unified' CPA that contains forecast expenditure for the full project, or a staged CPA that contains early works only. The NER requires TNSPs to undertake preparatory activities on actionable ISP projects, which must occur as soon as practicable (see NER, clause 5.22.6(d)). Preparatory activities are defined in the rules and we consider these distinct from larger early works activities that could be contained in a staged CPA.
Ex-post measures: benefits realisation Why is there no ex-post review on whether the market benefits estimated in the ISP and RIT-T are delivered? Currently we seem to assume that benefits accrue with no confirmation this is the case. Having an ex-post review would provide learnings for the future to improve the potential for claimed benefits to actually occur. It is consumers that ultimately fund these projects on the basis that they are delivering net benefits to consumers—so we would appreciate further investigation of how 'promised' benefits might be assessed ex-post. Consumers have the right for a report on the benefits that have been delivered. Just because benefits accrue over time is not a reason not to implement regular reviews of project benefits, say at 5-year intervals, to feed back into the RIT-T cost benefit analysis process to improve it. We could start with looking at the claimed benefits for the Heywood upgrade. Whilst there is certainty and low risk in the process for a TNSP, there is high uncertainty and high risks that a net market benefit will actually accrue. There is no feedback loop to confirm a benefit.	The ex-post review provisions set out in the NER are focussed on capex (that is, costs), not benefits. Under the current framework, we do not have a role in considering and/or reporting on benefits realisation as part of our ex-post statements.[3] Further, the ex-post statement may not be an appropriate mechanism for considering benefits realisation for actionable ISP projects, as the market benefits associated with these projects accrue over a long period of time. We recognise the concerns raised by stakeholders on when and how the benefits of these large ISP projects are tested against the costs and also whether there should be changes to the framework to measure whether those benefits are achieved. Whilst we cannot address this matter through the guidance note, we do note that, in preparing the ISP, AEMO undertakes a cost benefit analysis of projects to ensure it recommends an optimal development path that optimises net market benefits in the long-term interests of consumers. This is the key mechanism for ensuring that only beneficial investments are progressed. AEMO is currently consulting on its ISP methodology and stakeholders have the opportunity to respond to the issues paper it published in February.[4] This paper seeks feedback on a proposal for how AEMO could confirm that each actionable ISP project makes a positive contribution to the net economic benefit in the most likely scenario using the take one out at a time (TOOT) analysis. The aim of the TOOT analysis is to determine a project's incremental market benefit. In developing its ISP, AEMO also consults on the scenarios, inputs and assumptions used in its

[3] The capital expenditure incentives guideline set out the key rule requirements associated with ex-post measures. It states that 'Clauses 6.12.2(b) and 6A.14.2(b) [of the NER] require us to include in any draft or final regulatory determination, a statement on the extent to which the roll forward of the regulatory asset base (RAB) meets the capital expenditure incentive objective (defined in clauses 6.4A and 6A.5A [of the NER])'; see AER, Capital expenditure incentives guideline, November 2013, p. 13.

[4] AEMO, ISP methodology: Issues paper, February 2021, available at: https://www.aemo.com.au/-/media/files/stakeholder_consultation/consultations/nem-consultations/2021/isp-methodology/isp-methodology-issues-paper.pdf?la=en

	forecasting and planning activities to develop the optimal development path and actionable projects.[5]
Cost benefit analysis processes (inc. ISP feedback loop) Is the AER looking at how net benefits stack against the cost estimates provided to it in a TNSP's CPA? The decision to proceed with a project is that there are net benefits. If the CPA has a higher cost than the RIT-T project assessment conclusions report (PACR), then how is the AER assured that there is a still a net benefit? *ISP feedback loop questions* When the feedback loop is applied, may AEMO alter the values for costs and benefits calculated in the ISP? If that is the case, how does the feedback loop work from a practical perspective? Will the feedback loop tell us if there are still net benefits for the particular project subject to the CPA? Or will it only tell us that the project is still part of the optimal development path? If the latter, then the particular project could have negative net benefits that are more than offset by other projects in the optimal development path. How does the feedback loop work for interconnectors that straddle a non-Victorian state and Victoria? Is the whole actionable ISP project treated to the feedback loop assessment?	Our contingent project assessment and determination is focussed on the costs (or forecast expenditure) of an actionable ISP project. That is, whether forecast expenditure reasonably reflects the capital expenditure criteria set out in clause 6A.6.7(c) of the NER. Our contingent project assessment and determination is not intended to perform a cost benefit analysis. This function is undertaken as part of the transmission planning process. Specifically, AEMO's ISP performs the whole-of-system cost benefit analysis; the RIT-T performs an individual project cost benefit analysis that incorporates more detailed local knowledge and technical information; and the feedback loop undertaken by AEMO performs a final check that the project is aligned with the ISP optimal development path, before a TNSP can lodge a CPA for the project with the AER. If forecast project costs change significantly after the RIT-T application, this may constitute a material change in circumstances, which may require a reapplication of the RIT-T under clause 5.16A.4(n) of the NER. Further, before a CPA can be lodged with the AER, the TNSP must satisfy the actionable ISP project trigger event set out in clause 5.16A.5 of the NER. This contains the ISP feedback loop; as well as a criterion that 'caps' the forecast project cost to be used in the CPA to the project cost used in the feedback loop. The ISP framework was agreed by COAG Energy Ministers, who saw the need for more integrated whole-of-system planning to manage the energy market transition. AEMO is responsible for delivering the ISP, and a number of governance arrangements were put in place to support/oversee this, such as AER guidelines, the AER transparency review, the ISP Consumer Panel, and dispute resolution processes. **Responses to feedback loop questions** A number of questions were asked about the ISP feedback loop. AEMO is responsible for this and, as noted above, is currently consulting on its approach to its ISP methodology including how it will undertake the feedback loop and TOOT analysis.[6] We encourage interested stakeholders to raise issues and provide input to AEMO through its consultation process.

5 NER 5.22.8(a) requires AEMO to develop, consult and publish an Inputs, Assumptions and Scenarios Report to be used for the ISP.

6 AEMO, ISP methodology: Issues paper, February 2021, pp. 43-44.

The AER's cost benefit analysis guidelines also set out guidance for AEMO in performing the feedback loop.[7] This guidance is focussed on ensuring consistency of analysis between the ISP and feedback loop, while providing AEMO with flexibility to adapt the level of analysis to the materiality of changes in project costs/benefits between the ISP and RIT-T.

Risk types and allocation

It would be helpful to unpack what is an 'unforeseeable' risk per se, as distinct from unknown. It seems foreseeable (indeed inevitable) that capex will increase through stages as more information comes to hand, based on basically all historical transmission projects, even if the nature of the capex increase is not yet known.

Does the draft guidance note ask the TNSP to apply probabilities and then convert them to a dollar amount, even where it is not realistically possible (because it is an uncertainty)?

The cost pass through stage is too late to avoid impact on consumers of projects with a negative cost benefit going ahead.

We have a long history of cost overruns which are then passed on to consumers. In the case of Project EnergyConnect we have a project where the known costs are higher than the benefits, which leaves NSW consumers out of pocket. We think every transmission project gets approved and will always increase costs by 30 percent. We are still looking for something to give consumers assurance that there aren't going to be more costs heaped on, and there are better ways to address uncertainty.

Perhaps a good balance would be capping the forecast capex in the contingent project determination at the RIT-T estimate?

Can the guidance note better step through the risk for both consumers and investors, ex-ante and ex-post, to ensure there is a shared understanding of the risk, impact and sharing?

Our guidance note seeks to reduce actionable ISP project risk for consumers and TNSPs. It does this by encouraging TNSPs to undertake activities that promote proactive risk identification and management, effective project governance, and productive efficiencies in cost estimates (through procurement processes or using staged CPAs). This should increase the efficiency and accuracy of cost forecasts, and reduce the likelihood of cost overruns for actionable ISP projects.

Further, our draft guidance note operates within the existing economic regulatory framework, which allocates and shares risk between consumers and TNSPs in a particular way. We are considering ways we can increase transparency on risk allocation. The draft guidance note currently provides transparency on risk allocation by expecting TNSPs to identify all project risks it can foresee, and justify and quantify residual risks it seeks a cost allowance for. It also expects TNSPs to explain how they have allocated risk between themselves and contractors. Where risks are associated with events outside the TNSP's reasonable control, TNSPs can recover efficient costs through the cost pass through mechanism provided they fall within certain classes and meet a materiality threshold.

We agree the cost pass through mechanism is not a cost benefit analysis process. The cost pass through rules ask us to assess the efficiency of costs associated with positive cost pass through events, not the net benefits of the project as a whole (see NER, clause 6A.7.3). The ISP feedback loop is the key mechanism through which the cost of the project is assessed to ensure it remains actionable and aligned with the optimal development path before a TNSP lodges a CPA with the AER. AEMO is currently seeking feedback on a proposed approach for use in the feedback loop, to perform a TOOT analysis that confirms that each actionable ISP project makes a positive contribution to the net economic benefit of the optimal development path in the most likely scenario.[8]

We are considering how we can provide more explanation of risk allocation for both consumers and

7 AER, Cost benefit analysis guidelines: Guidelines to make the ISP actionable, August 2020, p. 48.

8 AEMO, ISP methodology: Issues Paper, February 2021, p. 43.

	investors, ex-ante and ex-post, under the current regulatory framework.
Other issues: Victorian planning arrangements We are concerned about the degree of transparency around AEMO's processes in Victoria for the new actionable ISP projects. We would appreciate updates of any outcomes that discuss increasing transparency of these processes for stakeholders. How is AEMO responsible for Victorian projects in relation to projects that cover NSW and Victorian regions?	AEMO is the market body responsible for the Victorian planning arrangements. We encourage stakeholders to contact AEMO with questions or concerns regarding its role and implementation of the Victorian planning arrangements. We also encourage stakeholders to contact AEMO regarding questions about Victorian transmission projects that cover both the NSW and Victorian regions. We note that AEMO advised, in its recent application of the ISP feedback loop to VNI Minor, which has costs and market benefits in both NSW and Victoria, that it considered the project as whole in the feedback loop.